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Security Nexus Perspectives

COVID-19, Debt, and Strategic Competition

By Dr. Alfred Oehlers [*]

Abstract

The current pandemic-induced economic crisis presents a unique opportunity for the United States and like-minded partners to reverse the gains China has made through its debt-led approach to acquire economic and political leverage. By addressing the debt challenges increasingly faced by some developing countries, the financial leverage China holds over any of these can be weakened significantly. Additionally, a multilateral response to the debt challenge grounded on current international rules-based norms, principles, and institutions, will counter Chinese intentions to create a parallel rival system centered on the Belt-Road Initiative. This approach will consequently also assume a crucial role helping shape the economic and financial architecture of the post-pandemic world to come.

Key words: COVID-19 pandemic, economic crisis, debt diplomacy, strategic competition.

There is mounting international concern over the debt burdens faced by many developing countries as the economic crisis induced by the COVID-19 pandemic intensifies. The International Monetary Fund (IMF) and World Bank, for example, have recently sounded an alarm bell about the financial stability of many nations faced with massive debt servicing requirements, but dwindling capacities to do so given catastrophic reductions in export incomes.[1] Flow-on contagion among defaulting debtor nations are a particular worry, with associated risks posed to the stability of the international financial system. A wide range of international humanitarian organizations, meanwhile, are similarly distressed at an emerging crisis likely to impact millions that are already vulnerable, with little recourse to livelihood support.[2] Warnings about the aggravation of widening gaps between haves and have-nots are now being issued with greater frequency, highlighting consequent risks to stability, security, and fragile governance

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*Dr. Alfred Oehlers is a professor at the Daniel K. Inouye Asia-Pacific Center for Security Studies (DKI APCSS) in Honolulu, USA. The views expressed in this article are the author's alone, and do not necessarily reflect the official position of the DKI APCSS or the United States Government.

structures. The dangers of COVID-19 spill-back contagion to the rest of the world as a result of these deteriorating conditions are stark and real.

While the above concerns provide persuasive rationales for a focus on the debt question, there is one additional dimension to this issue we should consider that gives compelling cause. Against a backdrop of geopolitical strategic competition, addressing debt – particularly through a multilateral effort led by the United States and like-minded nations – can be a highly effective way to weaken the economic and political leverage China possesses over debtor nations. Played well, the approach may even enable a reversal of the inroads China has made in the past against nations and at the expense of the international rules-based system.

Without question, the immediate concern relates to relieving the debt burden faced by debtor nations. In international discussions, a variety of possible measures are proffered, ranging from the suspension and deferral of servicing repayments, through to emergency credit lines to enable these nations to meet their obligations. Both the IMF and World Bank, for example, have called for bilateral and multilateral creditors to urgently support a suspension of debt repayments.[1] Both have also made available special credit lines that may be tapped to assist nations at greatest risk of default. Strong emphasis has been placed in these discussions on a unified international approach to providing relief. Encouragingly, traction is gaining on such multilateral approaches among the larger lenders in the world.

Ominously, however, one key lender has to date remained silent and eschewed such multilateralism: China. Consistent with its debt diplomacy playbook, it has chosen to engage bilaterally with individual debtors rather than risk being bound by any multilateral agreement aligned more consistently with internationally recognized financial norms. China's rejection of a multilateral pathway for debtor nations has sent a chilling message. There is a growing uneasiness among debtors that Chinese relief may not be in the offing, or even if it is, will be insufficient and perhaps also tied to conditions that may worsen their predicament. Alarming news concerning the impact of the economic crisis in China and widespread doubts about the robustness of recovery, have only heightened such fears that China will be less than magnanimous.

In this context of doubt and uncertainty, a more aggressive and unified international effort to provide urgent relief to debtor nations will yield huge dividends. Juxtaposing a unified multilateral humanitarian rescue package against a stubborn insistence on bilateral negotiations will throw into sharper relief the predatory nature of China's intent, and marginalize it even further. Built with safeguards preventing any leakage or transfers to repay Chinese debt, a carefully constructed multilateral approach will also isolate any Chinese lending and facilitate direct attribution back to Beijing of any financial fallout resulting from such debt turning sour. Ring-fencing Chinese debt in this manner insulates debtor nations from any deleterious consequences of default. With a lifeline tied to an alliance of international lenders, default on Chinese debt will have marginal impact on their credit standing. And should China seek redress through punitive debt recovery measures, the moral censure of the world will likely be heaped on any such attempt. In the end, for China, it may less a "debt trap" cunningly laid, and more a "credit trap" inadvertently fallen into – the only way out being the write-off of that debt, evaporating any strategic advantage it may have acquired.

Looking beyond immediate debt relief priorities, debtor nations in the short to medium term will also need significant support to stabilize and eventually resuscitate their economies. Much in the same way every advanced nation in the world is now embarking on fiscal stimulus packages of historic proportions, these nations will need similar measures just to prevent their economies from collapsing. In all likelihood, new lending will be required to support such programs, together with some restructuring and refinancing of existing commitments, and perhaps even the retirement of some past debt. No doubt, China may be a competitor in offering such lending to support fiscal stimulus and recovery processes. But as suggested above, China may be severely constrained given its own economic challenges and political priorities at home. Given this, a multilateral alliance of lenders may have a unique opportunity. Taking advantage of historic lows in interest rates and Chinese constraints, an aggressive push to fund government fiscal efforts may succeed in "crowding-out" Chinese lending and rebalancing debt portfolios in debtor nations in favor of multilateral lenders. Any hegemonic economic and political influence China may have enjoyed by dint of being a principal lender to the nation will be diluted – or even reversed – denying it any further strategic advantage.

Beyond general budgetary assistance and relief, keep in mind also the economic crisis has contributed to a significant weakening of the Belt Road Initiative (BRI) project program. It appears increasingly likely the BRI will not survive the economic crisis in its present form and will be reshaped significantly. To a degree, this was already on the cards with China's slowing economic growth, demographic constraints, the trade war with the United States, and a heavily over-leveraged economy. The economic crisis has only amplified these vulnerabilities, and with unemployment rising and business failures increasing, it is highly probable the focus of policy will turn increasingly inwards towards domestic economic revival and political stability. To the extent external BRI endeavors will be countenanced, a much reduced program, together with finer and more diligent scrutiny on the economic viability of these projects, is likely. No doubt, the resulting haircut will be cushioned by state banks. But there will be casualties, and some of the grandiose BRI projects of late around the world – currently in paralysis or life support – may not be resuscitated.

In this event, a big question for debtor nations will be – what do we do with these projects we have been saddled with, many with huge price tags and debt commitments? Some of these – for example, those in the vanity project category – can only be written off. But there are others that may be economically viable and capable of contributing meaningfully to development, that may be worthy of "rescue." An international alliance of lenders can step in and save such worthy projects, placing them on a sounder footing to resume, and with a refinancing package making them financially sustainable. For China – as if the failure of BRI projects will not be embarrassment enough – this "rescue" will be tantamount to the folly and bankruptcy of the entire BRI effort.

Some readers may ask: where is all this money coming from? How can such a massive program of debt relief be underwritten? And isn't this extremely risky? Without doubt, mind-boggling amounts will be involved. The United States and like-minded partners will have to dig deep to fund this effort. And there will be risks – inflation being a prime one to consider, particularly as a recovery gathers pace. These are all reasons why it is crucial now to transition the discussion from nationally-focused stabilization strategies to a broader internationally-focused discussion, emphasizing cooperation and coordination among major economic powers to amass the wherewithal to undertake this mission and guard against risks. What is needed is in the order of a global Marshall Plan rescuing not only nations, but the rules-based system itself. In the context of a strategic competition between a Communist, authoritarian command system and democratic, market-led system, the question should not be: Can we afford to do this? Can we afford *not* to do this?

This is not mere rhetoric. It is important to remind ourselves that one of China's key objectives in geopolitical competition has been to weaken the international multilateral financial system and create a parallel rival centered around the BRI and so-called "Beijing Consensus." A multilateral approach led by the United States and like-minded partners in addressing the urgent debt challenge – especially if nested within key organizations and processes of the international rules-based regime – will be a powerful antidote to these destabilizing efforts. Much as the foundations of post-World War 2 prosperity were laid prior to the end of hostilities through the Bretton Woods Agreement, we face a similar pivotal moment now. Make no mistake. What we do now in answer to the debt challenge, has the potential to shape the economic and financial order of the post-pandemic world to come. We cannot afford to let this opportunity to shape our economic and financial destiny slip by.

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